misallocated components of the TIC through a flat-rate regulatory policy cost recovery charge from telecommunications carriers as detailed in Section IV.D.[76] That charge would also recover separations allocations other than those in the TIC, such as for marketing expenses.[77] This regulatory cost recovery charge would be reduced, as appropriate, upon conclusion of the required separations reform. In the interim, it will afford ILECs a reasonable opportunity to recover costs incurred as a consequence of past regulatory decisions, while minimizing the impact on the marketplace.

C. The Commission Must Address Depreciation Cost Recovery Issues. (*NPRM*, ¶¶ 247-270)

ILECs have long been forced by regulators to accept uneconomic depreciation schedules in order to keep basic rates low. ILECs entered into this social contract with the understanding that they would eventually recover their investment, albeit over a period of years. However, the advent of competition has made recovery under the previous rules virtually impossible. GTE alone has a depreciation reserve deficiency of $7.1 billion, of which approximately 25 percent ($1.6 billion) is allocated to the interstate jurisdiction.[78] These deficiencies represent costs that were legitimately incurred with the approval of regulators, and ILECs are clearly entitled to their recovery.

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[76] GTE's cost recovery associated with the TIC in 1995 was $182 million.

[77] The Part 36 rules allocate marketing expense to the interstate jurisdiction based on revenues. This overallocates marketing expense to the interstate jurisdiction, which especially affects, through the Part 69 rules, the CCL and TIC rate elements. *See* USTA Comments. GTE's 1995 interstate marketing expense, as identified by the separations process, is $84.6 million.

[78] Corresponding figures have been used by USTA to develop an estimate of the

(Continued...)

In addition to the shortfall created from past depreciation practices, there is also the possibility that a future deficiency will exist if the Commission precludes ILECs from using economic depreciation lives on a going-forward basis. This forward-looking issue can and must be resolved in this proceeding.[79] Indeed, the 1996 Act eliminated the FCC mandate to prescribe depreciation rates. Now, the Commission is permitted to prescribe such rates only to the extent it finds such prescription to be appropriate. [80] Competitive circumstances preclude the FCC from making such a determination of appropriateness. To ensure an adequate level of cost recovery in the future, the Commission should provide ILECs with the flexibility to establish their own economically viable depreciation rates and to set prices based on those new depreciation rates. If the FCC does not permit such flexibility, it must allow ILECs to include any new depreciation deficiency in the competitively neutral recovery mechanism described in the next section.

(...Continued)
depreciation shortfall on an industry basis. *See* USTA comments in this proceeding. The figures developed for USTA assume that ILECs, on a going-forward basis, will be allowed to use economic lives and will be able to raise their access rates to recover uneconomic life depreciation expense. The figures presented here assume that it will not be possible to raise rates to recover economic life depreciation expense. GTE believes that this latter assumption is more realistic, hence the USTA figures are extremely conservative.

[79] GTE urges the Commission to act affirmatively in this proceeding and abolish prescribed depreciation rates. In doing this, the Commission will enable the ILECs to set depreciation rates in the same manner as their competitors. This proposal responds to the FCC's request that commenters address appropriate recovery mechanisms for these costs. *NPRM*, ¶ 248.

[80] 47 U.S.C. § 220(b).

D. ILECs Should Be Permitted to Establish Separate Charges for Recovery of Subsidies and Misallocated Costs Associated with Past Public Policy Decisions.

Justification for Mechanism. As described throughout these comments, the present access charge framework is the by-product of past political and public policy decisions reached in a highly regulatory environment. As a result, the current regime is riddled with implicit subsidies and cost misallocations. The Commission must allow ILECs to establish a competitively neutral regulatory policy recovery mechanism to recover all of the costs associated with these policy decisions. A competitively neutral mechanism would not distort investment decisions of telecommunication carriers or interfere with users' choice of carriers. It would assure that ILECs are not disadvantaged in the access market and all relevant costs are recovered. GTE's specific recommendations for recovery of the various categories of regulatory policy costs are set forth below.

Recovery of Regulatory Policy Costs. The regulatory policy recovery mechanism should recover: the transitional Reserve Deficiency Amortization ("RDA") resulting from under-recovered past depreciation expense, (as well as any future depreciation deficiency); and carrier common line costs (to the extent not recovered through the SLC or USF), separations-related costs, and regulatory policy-related transport interconnection costs. In addition, should the Commission mandate that local switching charges be priced based on hypothetical costs, such as its current formulation of TSLRIC/TELRIC be upheld, additional costs would have to be recovered from the regulatory policy funding mechanism.

Depreciation Reserve Deficiency. ILECs would identify the amount of the reserve deficiency (i.e., the amount of depreciation expense that would be needed to be booked to "catch up" the interstate depreciation reserve to economic levels) and determine how much annual recovery is currently included within each company's booked depreciation expense. The mechanism would be constructed to recover the past depreciation deficiency over a five-year period. [81]

TIC and Separations. For the separations and TIC-related components of the regulatory policy charge, each ILEC would submit separations-based cost studies to the FCC. The studies would show (1) the amount of marketing expense erroneously assigned to the interstate jurisdiction in accordance with existing Commission rules, and (2) the residual TIC revenue requirement remaining after the reallocation of specific costs to other rate elements.

Common Line. As stated above, as a matter of consistent Commission policy, interstate-allocated costs of the local loop should be recovered from end users. However, any amount of interstate loop costs not recovered through the SLC should be explicitly funded through universal service. Accordingly, the Commission must adopt a universal service plan which is sufficient to permit offsetting price reductions to the CCL charge that would effectively permit ILECs to eliminate such charges to IXCs entirely. If the new universal service fund is not sufficient for this purpose, the Commission should

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[81] Any future deficiencies caused by the failure of regulators to correct depreciation practices would have to be recouped as part of the regulatory policy recovery mechanism.

allow ILECs to recover revenues previously associated with the CCL charge through the regulatory policy element.

Difference between TSLRIC-based and current local switching rates. The recovery mechanism proposed here is appropriate for treatment of both the existing regulatory policy costs discussed below as well as future policy costs. For example, the Commission mandates that access services be priced based on hypothetical forward-looking costs rather than market-based rates, it would be intervening in the market and creating a new policy choice. Further, in prescribing the use of hypothetical forward looking costs (TELRIC) as the appropriate standard for pricing of unbundled elements in the *First Interconnection Order*, the FCC created a benchmark for pricing of access services with equivalent functionality.

The Commission should therefore utilize the regulatory policy recovery mechanism to recover the costs of this policy choice and guard against an uncompensated taking. Most notably, ILECs must recover the difference between the prescribed non-market based rates for local switching and existing rates after implicit subsidies are removed, in a competitively neutral manner.

Method of Recovery. Upon establishment of the regulatory policy charge, ILECs would make corresponding adjustments to their Network Services basket PCI to reflect removal of marketing expenses and reassignment of TIC costs to other access elements. The regulatory policy charge would be assessed on a bulk-billed basis to all telecommunications carriers that purchase interstate switched access, transport and network facilities used to provide interstate services from ILECs. This method is fair because it charges all the carriers that use ILEC networks.

The regulatory policy charge should be capped[82] at its initial value for a one-year period; however, ILECs should be permitted to charge less than the initial value if desired.[83] Annual adjustments to the regulatory policy charge would be limited to changes in costs allocated to the interstate jurisdiction that are being recovered by this charge.

V. DEREGULATION IS REQUIRED IN THE CURRENT MARKETPLACE TO ENSURE EFFICIENT PRICING AND EQUITABLE COMPETITION. (*NPRM*, ¶¶ 140-239)

Regardless of the state of competition in any particular market, the FCC should take immediate steps to reform its access charge rules to permit ILECs to adopt more efficient pricing. Full competition will be impaired if ILECs are forced to price in uneconomic ways and are unable to respond to their unconstrained competitors. Permitting ILECs immediately to move to rational pricing will affirmatively promote competition. Therefore, the FCC promptly should permit ILECs to offer volume and term discounts, geographically deaveraged rates, and customer-specific pricing, and to introduce new service offerings without delay.

Price cap structure reforms that more closely track current marketplace circumstances should also be permitted. In particular, the current complex and rigid

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[82] The RDA charge will be automatically capped as the past under-depreciated amount is amortized over five years.

[83] Because this charge represents explicit subsidy recovery and is not representative of specific services provided to customers, it should not be included in any access service price cap basket or category; nor should it be subject to any price cap mechanics (i.e., the price cap index ("PCI") adjustment formula).

scheme should be replaced with a one basket, three service category system with simplified bands and the Commission should forbear from regulating a number of services that are subject to competition. Likewise, the Commission should reform Part 69 in order to remove barriers to the introduction of new services and permit flexible rate structures that promote economic cost recovery.

The Commission should not condition pricing flexibility on the existence of certain competitive triggers in the marketplace. Although GTE fully supports the Commission's attempt to set up a mechanism for deregulating access charges, the Commission's proposal does not give ILECs the necessary flexibility to establish rational access pricing. Imposing competitive triggers would delay the benefits of efficient entry, create regulatory lag, invite endless litigation, and place ILECs at a severe competitive disadvantage. In addition, the particular triggers proposed are unlawful and unnecessary.

Finally, adoption of GTE's proposed reforms would not raise any appreciable risks to competition in the local and access markets. Under GTE's plan, numerous constraints will assure that ILECs do not enjoy any unfair advantage. As discussed in Sections II and III above, the availability of unbundled network elements provides an independent, highly effective check on ILEC access rates. In addition, GTE proposes to retain a PCI and zone-level pricing bands for services remaining within price caps. Likewise, access customers will be free to use special access services provided by ILEC or their competitors if switched access is priced at uneconomically high levels. Consequently, once subsidies and irrational rate structures are eliminated, allowing the market to function will promote rather than impede the development of competition.

A. Pricing Reforms Are Necessary to Permit Efficient Cost Recovery and Set the Stage for Full Competition in the Future.

To allow full competition to take root as envisioned by Congress, the Commission must allow ILECs to price rationally in accordance with market principles and must eliminate all unnecessary and destructive barriers to competition. Such actions must be taken regardless of the state of competition in order to send appropriate signals to prospective competitors and avoid both inefficient entry and uneconomic deterrence of efficient entry. In addition, immediate reform is needed to position the ILECs to compete equitably. As the Commission acknowledges:

> [I]naccurate pricing signals encourage uneconomic bypass of incumbent LEC facilities and could very well skew or limit the development of competition in the markets for telecommunications services. Furthermore, these rates may not be sustainable in the long run if unbundled network elements are made available at cost-based prices and used to provide exchange access services.[84]

Moreover, as discussed in detail earlier, IXCs can avoid access charges through arbitrage — an opportunity that is available only because of irrational pricing. To eliminate unfair arbitrage and promote fair competition, the Commission must allow ILECs the flexibility to price their products and services in an economically efficient manner.

B. The Commission Should Reform Part 69.

The Part 69 rate structure and cost allocation rules are an outdated relic of the monopoly market structure and rate base regulation that prevailed

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[84] *NPRM*, ¶ 55.

immediately after divestiture. In today's environment, these rules impair the introduction of new services and unnecessarily constrain an ILEC's rate structure.

The most significant problem with Part 69, as discussed in Section V.C.4 below, is that it defines a rigid rate structure that does not effect changes in technology and impedes the development and availability of innovative services. From a policy standpoint, these faults cannot be permitted to continue in the new market structure established by the 1996 Act. From a legal perspective, the delays inherent in Part 69 violate the streamlined effectiveness of access tariff filings mandated by new Section 204(a)(3).[85]

In addition, Part 69 is rife with cost allocation rules predicated on rate base regulation. Such rules serve no purpose in the reformed price cap system recommended by GTE, which simplifies the basket structure and eliminates sharing and the low-end adjustment. Accordingly, these rate structure and cost allocation rules are both inimical to fair competition and unnecessary and should be eliminated.

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[85] 47 U.S.C. § 204(a)(3). *See* GTE Comments, CC Docket No. 96-187, (filed Oct. 9, 1996); GTE Reply Comments, CC Docket No. 96-187 (filed Oct. 24, 1996). In that proceeding GTE asserted that the statute requires that all ILEC tariff filings are presumed lawful and must be permitted to take effect on short notice. Pre-tariff-filing approval procedures are flatly inconsistent with this new statutory provision, whether the approval procedure is a waiver or a public interest showing.

C. Pricing Flexibility Should Be Adopted Immediately To Promote Efficient Pricing.

1. Volume and term discounts.

The Commission should allow ILECs to offer volume and term discounts immediately. As the Commission "recognize[s] . . . significant benefits . . . may result from volume and term discounts, including the possibility that volume and term discounts may enable an incumbent LEC to reflect its actual costs more accurately."[86] Permitting ILECs to base rates on cost savings associated with volume and term traffic alone justifies adopting this proposal, regardless of the level of competition. The Commission's concern that CLECs might somehow be disadvantaged by allowing ILECs to offer these discounts is unjustified.[87] Currently, CLECs can provide such discounts without any restraints or preconditions. ILECs will only be able to compete effectively in the new marketplace if allowed to price with the same flexibility as CLECs.

GTE also disagrees with the FCC's tentative conclusion "that it would not be in the public interest to permit incumbent LECs to offer 'growth discounts' for particular access services."[88] If the FCC is to meet the 1996 Act's goal of robust competition, it must rely on important competitive tools such as growth discounts, which are simply a special type of volume and term discount. Smaller IXCs, which typically cannot qualify for volume discounts, benefit immensely from growth discounts. Limiting ILECs' ability

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86 *NPRM,* ¶ 190.

87 *See id.*

88 *Id.*, ¶ 192.

to offer these discounts would unfairly disadvantage smaller IXCs. To avoid this outcome, the Commission should allow ILECs to offer growth discounts immediately.[89]

2. Geographic deaveraging.

As discussed in Section IV.A.2., deaveraging is critically important to creating a rationally priced SLC. The same holds true for the pricing of other access elements. ILEC costs vary in different geographic areas, yet FCC rules require averaged rates across large territories. GTE has previously articulated how pricing inefficiencies result from requiring ILECs to compute study area-averaged prices for switched access.[90] Study area averaging has several disadvantages: it represses demand for switched network usage, it creates artificial incentives for access customers to choose non-ILEC access providers, and it establishes an artificial pricing umbrella.

Deaveraging, in contrast, allows ILECs to price efficiently and to compete for switched access services in a manner that is consistent with costs and competitive alternatives.[91] The Commission should therefore allow ILECs to establish

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[89] Although the Commission seeks evidence that growth discounts are cost-justified, that is not the issue to be resolved. The ILECs should be allowed to price in the same manner as their competitors, as long as costs are recovered. There are many reasons for offering discounts and other special incentives in a competitive marketplace. Growth discounts provide assurances that costs associated with network investment will not be stranded and allow the ILECs (and their competitors) to size their networks and to plan future investments with more confidence.

[90] *See* GTE Telephone Operating Companies Petition for Waiver of Part 69 of the Commission's Rules to Geographically Deaverage Switched Access Services (filed Nov. 27, 1995).

[91] Deaveraging access service rates will promote competition rather than creating additional distortions. In contrast, deaveraging unbundled loops must not precede deaveraging local rates because doing so would invite uneconomic arbitrage and

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geographically deaveraged pricing structures.[92] By pricing on a geographically deaveraged basis, ILECs will be able to establish efficient rate structures and rates based on (1) such factors as different cost or market characteristics or (2) state-ordered zones for unbundled elements and retail services.

To ensure that appropriate pricing signals are sent to CLECs and that facilities-based competition is not deterred, the Commission should allow ILECs to geographically deaverage rates for access elements. However, contrary to the Commission's suggestion, the flexibility to deaverage should not be contingent upon any competitive triggers.[93] Such a restraint would ignore the role deaveraging plays in efficient pricing regardless of the state of competition and would harm consumers by delaying competition.

3. Customer-specific pricing.

The FCC proposes to condition an ILEC's ability to provide contract tariffs and customer-specific pricing in response to requests for proposals on the existence of certain competitive conditions.[94] This type of regulatory constraint is unwarranted. All CLECs currently have the flexibility to offer customer-specific pricing. Denying ILECs

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(...Continued)
impede fair competition.

92 The FCC previously permitted ILECs to deaverage pricing of certain access prices. *See, e.g.*, Expanded Interconnection with Local Telephone Company Facilities, 7 FCC Rcd 7369 (1992).

93 *See NPRM,* ¶ 183.

94 *See id.,* ¶¶ 195-196.

the same flexibility places them at a severe competitive disadvantage. Such a result is inconsistent with the 1996 Act.

Indeed, the flexibility to offer customized access arrangements and pricing structures is warranted regardless of the level of competition. ILECs have been permitted to provide intrastate service at contract-based rates for years, regardless of the state of competition.[95] In addition, access customers demand this kind of responsiveness. Particularly in the switched access market, which is characterized by large, sophisticated buyers with substantial bargaining power, customer-specific pricing will promote efficiency without creating any risks to long distance competition. Under § 202(a) of the Act, any such arrangements would have to be offered to any similarly-situated access customer. This requirement both prevents discrimination and creates powerful disincentives to below-cost pricing. Moreover, claims that customer-specific, pricing is anticompetitive are incorrect; accordingly, such arrangements will promote, rather than impede, economically rational competition in the retail market.

4. New services deregulation.

In the *Third Report and Order*, the Commission allowed ILECs to introduce new services based on a "public interest" showing and granted the ILECs permission to file a "me too" waiver as long as the basis for granting the original new service waiver was not predicated on competitive data. Even under the new rules, however, an ILEC still

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[95] *See, e.g.*, General Order (G.O.) No. 96-A (Calif. Pub. Util. Comm. 1962); Fla. Stat. § 364.051.

must file a petition in order to introduce a new service.[96] In the *NPRM*, the Commission asks whether it should eliminate all requirements that an ILEC obtain regulatory approval before a tariff introducing a new service can take effect.[97]

The *Third Report and Order* fails to provide any real relief regarding new services. As the Commission found, "requiring an incumbent LEC to file a waiver to introduce a new rate element imposes a costly, time-consuming, and unnecessary burden on incumbent LECs, and significantly impedes the introduction of new services."[98] The same holds true for filing a public interest petition. There are still costs and unnecessary delays associated with filing such a petition.

In addition, the *Third Report and Order* is fundamentally inconsistent with Section 204(a)(3) of the Act. Under that section, access rates become effective on seven or fifteen days' notice. Any prior approval requirement — and indeed any Part 69 rate structure — necessarily violates the statutory streamlining.

If the Commission sincerely wants to eliminate any delay in bringing innovative services to the consumer, it should remove all regulatory roadblocks. The costs of obtaining regulatory approval outweigh the benefits. Indeed, as the Commission states, "[b]ecause the underlying core access service offerings, as well as unbundled network

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96 *See* NPRM, ¶¶ 199, 309-310.

97 *Id.*, ¶ 199.

98 *Id.*, ¶ 309.

elements, would still be available, there may be little benefit from requiring an incumbent LEC to obtain regulatory approval before introducing a new service."[99]

Likewise, the Commission should not adopt access charge rate structure rules for services using new technologies, such as ATM, SONET and AIN.[100] These technologies enhance the reliability and efficiency of the network and enable new transport and switched data services. Because CLECs and other carriers already make use of these technologies, market forces will require ILECs to adopt competitive rate structures and prices for such services. Moreover, the current rules allow ILECs to introduce new services at rates that exceed average variable cost.[101] Therefore, there is no need to further complicate the rules for introducing services based on new technologies. The purpose of the 1996 Act was deregulation, and that should be the intent of this proceeding. The Commission should eliminate the rigid part 69 rate structure rules, not micromanage new services that are being introduced into a competitive marketplace. If it nonetheless elects to prescribe a new rate structure, it must permit ILECs to recover the costs of implementing the new rate structure.[102]

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99 *Id.*, ¶ 199.

100 *See id.*, ¶ 139.

101 Policy and Rules Concerning Rates for Dominant Carriers, CC Docket No. 87-313, Second Report and Order, 5 FCC Rcd 6786, 6816 (1990), *recon.*, 6 FCC Rcd 2637 (1991), *aff'd*, National Rural Telecom Ass'n v. FCC, 988 F.2d 174 (D.C. Cir. 1993) ("*Price Cap Second Report and Order*").

102 A prime example of the need for such recovery is the proposal to recover certain SS7 costs on a usage-sensitive basis. *NPRM*, ¶¶ 131, 133. Doing so would require the procurement and development of expensive new equipment.

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For all of the foregoing reasons, the Commission should not hamstring ILECs with undue and intrusive regulatory constraints. Pricing flexibility and a deregulatory environment will ensure that rational pricing emerges and the proper economic signals are sent to both end users and telecommunications providers.

D. The Price Cap Basket Structure Should Be Completely Overhauled.

The Commission tentatively concludes that, given actual competition, the current service categories in the trunking and traffic-sensitive baskets are no longer necessary.[103] GTE submits that substantial reform of the basket structure is critical in the new environment created by the 1996 Act, notwithstanding the level of competition in a particular market. The existing structure of four baskets and multiple service categories, subcategories, and zones is cumbersome, outdated, and undermines the pricing flexibility and operational efficiencies that price cap regulation is intended to foster. However, the limited modifications proposed by the Commission are insufficient to promote rational pricing of access services. Instead, the Commission should develop a new price cap structure with a single basket consisting of those network services that currently are not fully competitive.[104]

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[103] *See id.*, ¶ 211.

[104] As discussed in Section IV, the remaining common line costs (if not recovered through the USF or from SLCs), separations-related costs currently in the TIC, and other regulatory policy costs should be recovered through a mechanism separate from price caps.

Specifically, the Commission should combine all services for which price cap regulation may still be warranted into one basket called "network services." *See* Figure 1. This new basket should have three service categories (tandem switching and transport,[105] local switching,[106] and database services[107]). Both the tandem switching and transport and local switching service categories would have associated zones. Pricing constraints would be present at the basket level through the PCI, at the service category level for database services, and at the zone level for tandem switching and transport and local switching through an upper band limit.

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105 This service category includes all tandem switched transport-associated rate elements (i.e., tandem switched transport and the tandem switching charge).

106 The local switching service category includes services in the current local switching category, the information surcharge, operator transfer, and busy line verification and interrupt. This service category is very similar to the current local switching service category.

107 The database services category includes the current service categories of 800 database, billing name and address, and line information database (LIDB).

PROPOSED
LEC PRICE CAP STRUCTURE

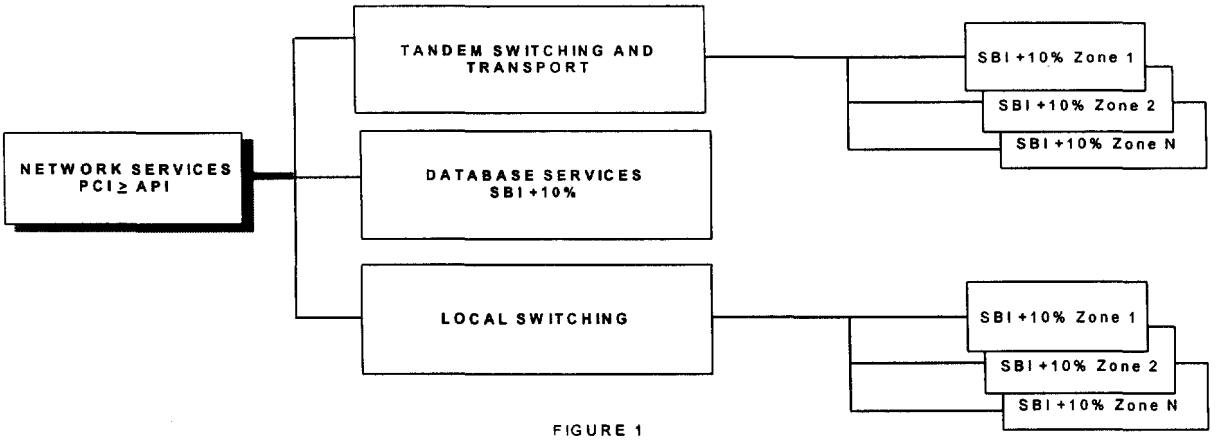

FIGURE 1

For the most part, the new price cap structure would operate on similar terms as the old structure. The ability to raise overall prices would still be limited by the PCI (i.e., the actual price index ("API") would have to be equal to or less than the PCI). Certain modifications are warranted, however.

First, the Commission should eliminate the sharing and low-end adjustment mechanisms because they are no longer consistent with price cap goals. Sufficient competition exists to render earnings regulation unnecessary and permit price cap ILECs to accept the full risks and rewards of incentive regulation. Second, the current unwieldy and unduly limiting array of baskets and service categories, subcategories, and zones (each of which is limited by upper bands) must be greatly simplified. Doing so will enable ILECs to mitigate many of the irrational rate relationships resulting from past regulation. Third, the Commission should allow ILECs to establish different geographic zones for each service category, as discussed in Section V.B.2., above. The zones should be selected based on the criteria most appropriate for the associated

service category, with no limit on the total number of zones. Each zone should have an upper banding constraint of ten percent relative to the change in the PCI, per year, in order to alleviate any concern about possible rate shock. An ILEC can file a forbearance petition under Section 10 of the Communications Act whenever it believes ILECs have become subject to effective competition. Upon making such a showing, the ILEC should be permitted to remove the service from price cap regulation.

This proposed price cap structure offers several significant advantages. It provides the price cap ILECs with the pricing flexibility necessary to adopt rational rates and compete in the new environment. It also provides for the minimum level of regulatory oversight necessary for those services not yet subject to full competition. Finally, it is administratively simple.

E. The Commission Must Establish A Productivity Factor Methodology That Accurately Estimates The Next Year's Productivity Gains.

The Commission will also have to address the issue of an appropriate productivity factor for the price cap LECs under the new access charge regime. While this issue received considerable attention in CC Docket No. 94-1,[108] that discussion failed to consider the significant changes being contemplated in this proceeding. Clearly, when estimating any proposed productivity numbers, the Commission must take into account the changes created by the 1996 Act, the Commission's *First*

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[108] *See* Price Cap Performance Review for Local Exchange Carriers, Fourth Further Notice of Proposed Rulemaking, CC Docket No. 94-1, 10 FCC Rcd 13659 (rel. Sept. 27, 1995).

Interconnection Order, and the access rate structure charges that are the subject of this proceeding. Any productivity factor must represent what the ILECs will be capable of achieving in the new environment; the Commission must not "invent" a productivity factor just to drive rates to a level it thinks is appropriate. GTE continues to support the use of Total Factor Productivity ("TFP") as the most accurate measurement of productivity.

Specifically, GTE recommends that the TFP evidence placed on the record by USTA in CC Docket No. 94-1 should be updated to reflect the impact of the regulatory policy costs recovery mechanism (thus eliminating both revenues and MOUs from the TFP calculation); the change from usage-based to flat-rated charges for certain rate elements (e.g., line ports); and the increasingly competitive and risky nature of the business. Consideration of these factors is critical to developing a true estimate of achievable productivity.

F. The FCC Should Grant USTA's Request for Forbearance From Regulating Certain Access Services That Are Subject to Competition Throughout the Nation.

The Commission should immediately forbear from regulating access services with significant competitive alternatives under its Section 10 authority. Section 10 requires the Commission to forbear from regulating any carrier or service if the Commission determines that:

(1) enforcement is not necessary to ensure that rates are just and reasonable and are not unjustly or unreasonably discriminatory;
(2) enforcement is not necessary to protect consumers; and

(3) forbearance is consistent with the public interest.[109]

This three-pronged test is met today with respect to the following services: special access and switched access dedicated transport;[110] interstate intraLATA; operator surcharge services; and directory assistance. For all of these services, prices are constrained because consumers enjoy competitive alternatives. In the remainder of this section, GTE will provide additional information in support of USTA's industry-wide request.[111]

Special access and switched access dedicated transport. Direct substitutes for special access and switched access dedicated transport have been available for a long time. Almost three years ago, GTE supplied the FCC with an 18-page listing of competitive access providers ("CAPs") operating in its territory.[112] At that time, GTE pointed out that the concentration of market demand for access makes this market extremely vulnerable to competition. For example, six percent of GTE's end user customers account for 46 percent of GTE's interstate switched access demand; seven tenths of one percent of GTE's customers account for 20 percent of switched access demand; six-tenths

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[109] Communications Act, § 10(a), *codified at* 47 U.S.C. § 160(a).

[110] Switched access dedicated transport consists of direct-trunked transport, entrance facilities, and the serving wire center to tandem links.

[111] GTE may file a Petition for Forbearance covering these services in the future, which will be mooted if the Commission elects to order forbearance of these services in this proceeding.

[112] Comments of GTE, CC Docket No. 94-1, at Attachment C (filed May 9, 1994).

of one percent of GTE's end users account for all of GTE's special access terminations; the top 13 percent of GTE's end offices originate or terminate 71 percent of GTE's switched access demand; and 92 percent of GTE's special access channel terminations are located in these offices. Information from 1997 reflects the presence of at least 50 CAPs in 140 GTE end office serving areas in 15 states. These serving areas represent less than four percent of GTE's end offices but provide access to:

- 33 percent of GTE's business lines;
- 26 percent of GTE's interLATA MOU;
- 54 percent of total GTE DS1 facilities; and
- 78 percent of total GTE DS3 facilities.

GTE estimates that approximately 14,000 equivalent DS1 facilities are now provisioned by CAP facilities in GTE markets.[113] These facilities represent nearly eight billion equivalent end user MOUs[114] lost to GTE's competitors and the capacity to transport

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[113] This includes end user losses to facility bypass and transport services due to collocation arrangements. This information is based primarily on GTE's knowledge of the result of competitive bid situations and specific information provided by former customers. GTE has no way of determining all the competitive losses sustained in its markets or of the total market for special access services. This is GTE's main objection to any "triggers" for relief based on criteria, such as market shares, that are unavailable to an ILEC or, in fact, unavailable to the Commission.

[114] This MOU figure was estimated based on 108,000 monthly MOU per equivalent end user DS1 lost to competition.

more than 10 billion equivalent MOUs via switched and special access collocation arrangements.[115]

Moreover, the 1996 Act, along with the Commission's *First Interconnection Order*, virtually guarantees the availability of products and services substitutable with special access and switched access dedicated transport through the recombination of ILEC unbundled elements. In addition, the statute's collocation requirement makes it very easy for a CAP or IXC to combine its facilities with ILECs' unbundled elements to compete directly with ILECs' special access and switched access dedicated transport services. Clearly, not only is competition possible, but present and robust. The level of competition controls rates, protects consumers, and compels deregulation of these services in order to advance the public interest.

Interstate intraLATA services. The interstate intraLATA market is very competitive and will only become more so with the implementation of dialing parity as required by the 1996 Act and the *Second Interconnection Order.*[116] As that Order states, a national "2-PIC" standard will speed competitive entry into the intraLATA and intrastate toll markets.[117] Indeed, in GTE market areas, 14 states either already have dialing parity or will have it in the next month or two. These states include Hawaii, Illinois, Florida, Washington and California, which contain GTE's largest operating

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115 Nationwide, 273 DS3 and 416 DS1 cross-connects are in service.

116 *See Second Interconnection Order*, ¶ 49.

117 *Id.*, ¶ 50.

areas. In addition, GTE has filed dialing parity tariffs in all of its remaining states except Texas.[118]

If the Commission employs the same rationale in considering the ILECs' interstate intraLATA service as it did in classifying AT&T as a nondominant carrier, it must reach the same result and forbear from regulation of ILEC services. There, the Commission found that "the interexchange market enjoys substantial competition today.[119] It also concluded that AT&T's market power over certain *de minimis* services did not warrant retaining the dominant carrier classification because AT&T lacked overall market power for domestic, interstate, interexchange services, and dominant carrier classification stifled innovation and imposed compliance costs on AT&T.[120]

ILEC interstate intraLATA service is offered in the same competitive market as AT&T's services and constitutes a *de minimis* amount of revenue when compared to the overall nationwide market. This is especially true of independent ILECs. The "all other" LECs' share of the nationwide market is 3.143 percent, significantly smaller than AT&T's share.[121] Even this figure excludes companies with less than $100 million in annual revenues and is therefore inflated.

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118 It is anticipated that the Texas PUC will adopt rules in February 1997.

119 *See* Motion of AT&T Corp. To be Reclassified as a Non-Dominant Carrier, 11 FCC Rcd 3271, 3290 (1995) ("*AT&T Domestic Order*").

120 *See AT&T Domestic Order*, 11 FCC Rcd at 3356-57.

121 Long Distance Market Shares: Third Quarter 1996, Industry Analysis Division, Common Carrier Bureau, at Table 5 (Jan. 1997) ("CCB Long Distance Market Shares").

The first two prongs of the forbearance test for interstate intraLATA service are satisfied by the Commission's finding in the *AT&T Domestic Order* that the domestic, interstate, interexchange market was competitive enough to reclassify AT&T as nondominant even though it retained a 58 percent share of the market. The FCC based its non-dominance finding on: (1) high supply and demand elasticities in the interexchange marketplace; (2) no real barriers to entry; and (3) market conditions that did not allow AT&T to maintain artificially low prices long enough to drive its competition from the market and still be able to recover any associated losses.[122] If AT&T, which today has a 54 percent market share of revenues,[123] cannot exert market power for the services it offers in competition with all nondominant interexchange carriers, then neither can any ILEC.

The Commission also must "consider whether forbearance from enforcing the provision . . . . will promote competitive market conditions, including the extent to which such forbearance will enhance competition among providers of telecommunications services."[124] Forbearance from regulation of interstate intraLATA service will enhance competition. Under dominant carrier regulation, many tariffs must be filed on 45 days' notice and provide full cost support, and all must be filed on at least 14 days' notice. The IXCs, on the other hand, are no longer required to file tariffs and can react

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122 *See AT&T Domestic Order,* 11 FCC Rcd at 3346-47.

123 CCB Long Distance Market Shares, Table 6.

124 47 U.S.C. § 160(b).